Flash Economics

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How would the European economy respond to a prolonged closure of the Strait of Hormuz?

Before the outbreak of the Middle East war, the following transited through the Strait of Hormuz:

- 7% of oil consumed in Europe;
- 5% of natural gas consumed in Europe;
- 19% of kerosene used in Europe.

The European economy will react in two ways to the reduction in oil, natural gas and refined product supplies:

- A rise in the prices of oil and natural gas, refined products, and derivatives of oil or natural gas (fertilisers, plastics), driven by the fall in available quantities. This price increase generates both an adverse demand shock (lower household purchasing power) and an adverse supply shock (higher production costs for businesses);
- Rationing of consumers and businesses, because countries are competing with one another to secure sufficient supplies of oil, natural gas and kerosene, and because price increases alone cannot sufficiently reduce demand for oil, natural gas and products derived from them (fuels, plastics, fertilisers...).

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The direct impact on Europe of the closure of the Strait of Hormuz

Before the outbreak of the Middle East war, 14.3 million barrels of oil per day and 118.8 billion cubic metres of natural gas per year transited through the Strait of Hormuz, against global consumption of 102 million barrels/day of oil and 4,147 billion cubic metres of natural gas per year. Before the closure of the Strait of Hormuz, the quantity of oil bound for Europe transiting through the Strait was 0.6 million barrels per day, representing 7% of European Union oil consumption (8.6 million barrels per day). In 2025, the quantity of natural gas bound for Europe transiting through the Strait of Hormuz was 16 billion cubic metres, representing 5% of European consumption (289 billion cubic metres). For refined products, 19% of the kerosene (jet fuel) used in Europe comes from refineries located in the Persian Gulf.

One might assume that the shock resulting from the closure of the Strait of Hormuz would therefore only affect airlines, but account must be taken of the fact that different regions are competing for their supplies of oil, natural gas and refined products. This competition has given rise to **a sharp rise in the oil price** (**Chart 1**), **natural gas price in Europe** (**Chart 2**), **kerosene** (**Chart 3**) and **other refined products** (petrol, diesel).

Chart 1
Oil price (Brent, $/bbl)

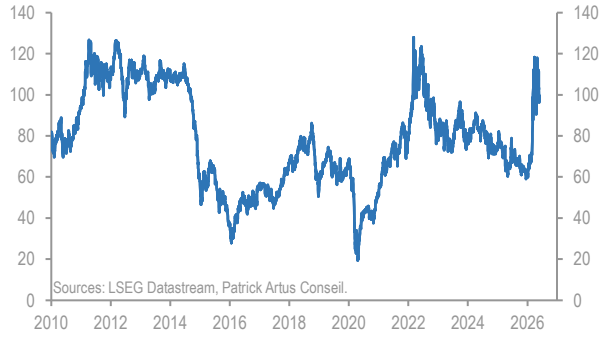


Chart 2
Europe: Natural gas price (€/MWh)

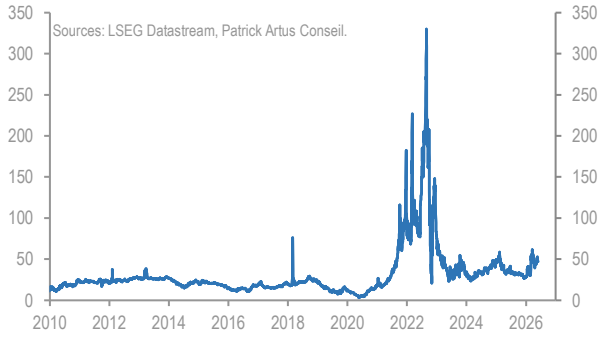


Chart 3
United States: Kerosene-type jet fuel price (USD/gallon)



The impact on the prices of products manufactured from oil or natural gas

The rise in oil and natural gas prices feeds through to **products manufactured from oil or natural gas** such as polyethylene (used to make bags, films and flexible containers), **polypropylene** (used to make moulded parts, packaging and fabrics), **urea** (used to make fertilisers). Since the end of February, fertiliser prices have risen by 44%, polyethylene prices by 53% and polypropylene prices by 50%.

These price shocks on oil, natural gas and products manufactured from oil and natural gas generate a **dual shock**:

- **A negative supply shock**, stemming from the decline in production profitability (for plastics, fertilisers, transport…);
- **A negative demand shock**, stemming from the decline in household purchasing power and hence demand for goods and services.

This dual shock leads to:

- **A decline in output** (**Charts 4A/B**);

Chart 4A
Euro zone: Real GDP

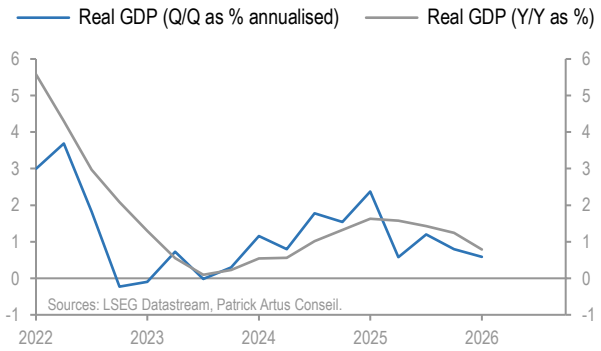
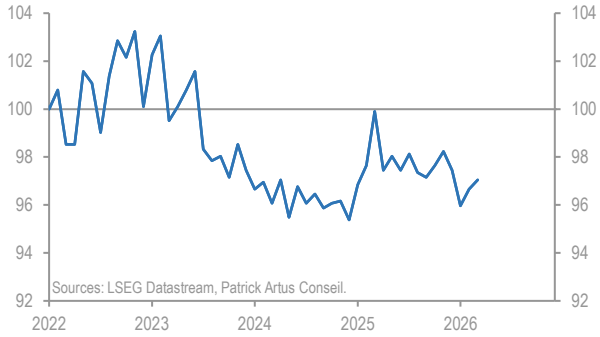
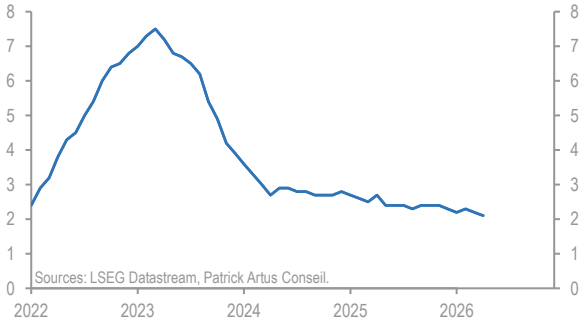


Chart 4B
Euro zone: Manufacturing production (2010.M1 = 100)



- **An increase in prices**, subdued due to the fall in demand. It is still too early to observe this anticipated rise in core inflation (**Chart 5**).

Chart 5
Euro zone: Core inflation
(HICP excl. energy and unprocessed food, Y/Y as %)



The rationing of available quantities

If all energy, goods and services markets were at competitive equilibrium, **there would be a rise in prices rebalancing supply and demand ex post** (fuels, natural gas, plastics, fertilisers, transport…). However, **prices are not sufficiently flexible to allow this adjustment** through purely competitive supply and demand for the various goods and services. **Rationing will therefore emerge**, for example on:

- The number of flights operated by airlines;
- Available packaging (for food, for medicines…);
- The quantity of fertilisers available.

These rationing effects will erode the level of output and will add to the output reduction arising from the negative supply shock and the negative demand shock.

Summary: a sharp growth slowdown

Overall, a sharp slowdown in European growth is to be expected, driven by:

- The negative impact on the supply of goods and services from higher prices of oil, natural gas, refined products and derivatives of oil and natural gas;
- The negative impact on demand for goods and services given the drain on European household incomes resulting from higher imported energy prices;
- The negative impact of rationing on the production of certain goods (fertilisers, plastics…) and on services (transport).

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